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INTERLOCKING CORPORATIONS

ONCE more a striking phrase has suddenly become a part of our everyday speech and with it a cause, though it is as yet a more or less indefinite cause, has found a measure of prosperity. It is an effective phrase, one in which an advertising agent or a seeker of political catch words must take a pure delight. "Interlocking directorates." You do not have to hear it often to find yourself thinking of the boards of directors of many of the big corporations in the land as mortised and fitted to work in perfect unison—an interlocking, interchangeable, intercorporate marvel of the joiner's art. Nor does the imagination far outstrip the facts. In every city of any size how many interlocking corporations are there? How many are there in the big cities; some of state-wide importance, some of national or even international influence?

The Steel Corporation, for example, is a morsel to roll under any man's tongue. Here is the way it impresses one militant journalist:

> "The Steel Trust's advantage over competitors of three dollars a ton in cost of production, due not to superior efficiency but to the ownership of certain strategic railroads and steamship lines, is greatly enhanced by its relations to many other carriers. The few men who control the Steel Corporation are directors also in twenty-nine other railroad systems, with 126,000 miles of line—more than half the railroad mileage of the United States—and in steamship companies. These men are also directors in twelve steel-using street railroad systems, including some of the largest in the world; they are directors in forty machinery and similar steel-using companies; in many gas, oil, and water companies, extensive users of iron products; and in the great wire-using telephone and telegraph companies. The aggre-

> gate assets of these different corporations exceed sixteen billion dollars. Sixteen billion dollars is more than twice the assessed value of all the property of New England. It is more than one and one-half times the assessed value of all the property in the thirteen Southern States. It is larger than the assessed value of all the property in the twenty-two States, North and South, lying west of the Mississippi River, except only Texas."[1]

Interesting, even startling, but in a measure misleading, if these great properties are considered as being under a common control. The common control extends to a considerable part of them; with the others this relation means little more than ease of intercommunication or ability to respond quickly to a common impulse, for a common benefit or defense. On the other hand, the Steel Corporation is not the only sun with satellites in the American sky. There are several others.

However, the new-found phrase has proved in a measure tyrannical. As is so often the case with such phrases, being a catch-word it has bred impulsive judgment—it has turned attention to one side of a big problem and has effectively excluded most others. First, it has begged the question—it has created an assumption that interlocking directorates are in and of themselves undesirable. But this might be indulged, if it had not so totally obscured the big questions that lie just behind. Directors, after all, are merely the agents or trustees of corporations. A corporation's owners are the principals. Its big stockholders—and yes, begging leave, its little ones—are the men behind the guns. If interlocking agents are anathema why not interlocking principals? Yet the question of common ownership is as effectively obscured as though it were almost non-existent.

The problem is more than this. Indeed it is not one but several problems. The question of intercorporate directorates, it must be granted, is a question of importance. But it is indissolubly connected with several others. The questions of intercorporate contracts, of intercorporate combinations, consolidations, leases and sales, invite thought in which the intercorporate directorate may be but incidental, a background shadow. And brooding over all is always the question of the interlocking ownership of these corporations, the interfinancial hegemony, which can no longer be obscured. Moreover each and all of these problems has two sides. Public

[1] In Collier's Weekly, Oct. 5, 1912. Compare the testimony taken by the Pujo investigating committee of the House of Representatives, especially that taken on Dec. 18, 1912.

and private interest differ and are not the same. Intercorporate directorates, intercorporate ownership, contracts between corporations having common directors or ownership, may signify one thing from the standpoint of a minority stockholder, another from that of the majority stockholder, and still another from that of the public. And all of these questions may in turn be qualified or entirely metamorphosed by the nature of the business in which, as it happens, the particular set of interlocked corporations under examination is engaged. If the corporations are small or middle-sized merchandising corporations, the consuming public may be specially exercised at their real or imagined practices. If they are industrial corporations, labor will be particularly alert to all their doings. If they are public service corporations, they will always entertain a medley of interested inquisitors—a little bit of this, that and the other thing. If they are corporations of the secret process brand, or if they are close corporations, or if they are in any sort of business in which reticence is something more than good manners, they may experience one sort of thing—which may sometimes prove very painful—whereas if they are corporations of the banal, open-to-everybody kind, or the kind that has an assured monopoly, a perpetual franchise, and stock and bonds all listed on the stock exchange, the experience may, as a rule, be quite different. A little more discrimination than we have had thus far in the interlocking directorate controversy—which doesn't quite cover everything in the trust and corporation question—may prove helpful.

Most of all, differentiation would be welcome in dealing with the concern of the stockholder on one hand, that of the public on the other. Obvious as the need of this may seem to be, it has been somewhat lacking.

The stockholder's interest in the corporation is that of a property holder, his relation to the director is that of one of several joint owners of property to their representatives and managers—representatives and managers who have very full powers indeed, who can help the stockholder or hurt him beyond repair. The stockholder's prime concern is that the director shall work always and all the time for the corporation, for that means he will work for the stockholder. The director may be, and if he is a big man in the business world, he is likely to be, a director in other corporations, perhaps in several of them. That of itself may mean nothing of importance to the stockholder. The corporations in which the director is interested as director may never come into commercial contact with his own, or their contact may be in its effect neutral or even beneficial. But once the director is interested as director

in a competing corporation, or in a corporation which performs a service or produces a commodity or possesses property which the other corporation desires to buy, then the situation changes immediately. The director is at once in the position of one who seeks to serve two masters whose interests are or may easily become more or less conflicting and antagonistic. Can he maintain a perfectly even balance? Will he dot every i, cross every t, do equity like a Solomon? When contracts are made between the two corporations is there not danger that he will give one of them the better of it? The danger is a very real one, and the opportunity presented has tempted many men in just such situations to do gross fraud.

Perhaps it will be said that the stockholder has himself to blame if he permits conditions which make such discrimination or dishonest dealing easy. That would be true if the stockholder's position were that of the ordinary employer or owner. But this is not the case. While in certain respects his rights and powers are like those of such an employer or owner, in others they are entirely unlike them. Unless he owns a working majority of the stock himself he cannot say who shall be the directors; he cannot say that a part or even all of the directors chosen shall not hold like positions in one or a dozen other corporations, any or all of which may be competitors of his own corporation; there is as yet practically no positive law against intercorporate directorates, intercorporate principals or intercorporate contracts between such directorates or principals. What means the stockholder has to protect himself are curative rather than preventive.

And there are impediments—sometimes exceedingly difficult to overcome—even in the way of administering the cures. Nowhere perhaps is this better illustrated than in the existing state of the law concerning the stockholder's right to inspect the books and papers of the corporation. It is laid down as a broad general proposition that one of the privileges incident to stock ownership is that of inspection of the books and papers of the corporation, and that this privilege in general becomes a right "when the inspection is sought at proper times and for proper purposes." In many of the states this right has been expressly guaranteed by statute, in some by the constitution—but the right, such as it is, exists at common law, independent of legislative act or constitutional guarantee. Such as it is. For as a general thing it is a right which can be availed of only with difficulty even when the exercise of it seems almost imperative. In ordinary relations it often seems practically impossible to assert it effectively. Some courts have been more liberal than others in permitting examination of the corporation's books

and papers by the stockholder. In certain cases the privilege has been granted when the only purpose of the stockholder appeared to be to acquire information to enable him to vote intelligently. But no one who looks into the matter can fail to be impressed with the character or apparent number of the instances in which the privilege has been refused. The corporation may cease to pay dividends; the market value of its shares may greatly decrease; the officers may discontinue their reports to the stockholders; the directors may decide to lease or dispose of a part of the property; they may decide to bring suit against one or more of the stockholders. In such cases the stockholder's anxiety will be very real and the only ways in which it can be allayed will be through the assurances of officers and directors whom he trusts or by an examination of the condition of the corporation itself. Yet in cases of precisely this character stockholders seeking information have gone away empty handed, and the courts have refused relief.

Overmuch stress of course is not to be placed upon this condition of affairs. A fair balance must always be maintained. A corporation is a business enterprise and like most business enterprises it has a business privacy which cannot be invaded and business secrets which cannot be divulged without injury to the stockholders themselves. The director as a trustee of the corporation—and he is a trustee of the corporation first, of the stockholder only secondarily—is often under obligation to preserve these secrets even against the stockholder himself. These secrets may be secrets of process in manufacture; specialized and therefore more or less secret knowledge of markets, of when to buy or to sell to the best advantage; but they may also to some extent—to a reasonable extent—be secrets of business condition. It may for a time be as important to a corporation to keep its competitor in the dark concerning its profit and loss account or its borrowing power as it is to keep from that competitor all knowledge of the ingredients entering into the thing it sells. But admitting all this, the privilege of non-communication can easily transcend the bounds of fairness to the stockholders. It can easily be made to cloak a scheme to deceive the stockholder as to his holdings, to help directors working for their own private pockets or for their underground financial prestige. It is a sinister privilege at the best.

When with a stoutly claimed privilege of silence, of non-communication, there co-exists a situation facilitating and inviting intercorporate relations or contracts or alliances which may easily prove to be to the detriment of stockholders in one or more of the corporations concerned, who can doubt that the privilege should be sub-

ject to the closest scrutiny, that the presumptions of the law should favor the stockholder and lodge the burden of showing fairness upon the shoulders of the directors? Who can doubt that all contracts made between such corporations where the common directors of all constitute an acting majority or a powerful influence in each should be strictly voidable and that it should be possible for a very minor stockholding interest to set in motion the machinery which would determine whether the contract was fair or prejudicial?

What the law has accomplished in this respect and what it may yet incline to accomplish deserve consideration and careful study. It will be found that the courts have made much more than a beginning, that they have recognized and often protected the infirmities of the stockholders even if they have not often taken those final steps which would make the stockholder quite independent in his dealing with the corporation.[2]

A very few courts have held that contracts between corporations which have common directors—under certain conditions at least—are void. Usually, however, in such cases the true reason why they have been held void is that the transaction was fraudulent. A considerable number of courts are to be found at the other extreme. They hold that the contracts are valid, but usually they say that they are subject to strict scrutiny and must be fair. But the rule upheld by most courts is that they are voidable. Some say that such contracts may be avoided "without regard to the question of advantage or detriment," but the great majority permit avoidance only when in addition to the common directorship some element of adverse interest, agency or fraud is present.

The rule that declares all such contracts void seems oppressive. The rule that declares them valid, on the other hand, is much too liberal. It makes common directors feel that they have free rein, that the presumptions are in their favor. The true policy seems to lie between—where most of the courts have located themselves. The contracts should be regarded as voidable whenever any advantage has been taken of the stockholders on either side. The utmost good faith should be required of those who make such contracts. And therefore to protect fully the interests of the minority and the individual stockholder does it not seem that the individual stockholder—provided he is not shown to be a gratuitous trouble-maker—should have power to begin proceedings in the courts which would lead to avoidance of the contract if any

[2] Some of the most important phases of this matter are discussed by the writer in an article entitled "The Validity of Contracts between Corporations Having Common Directors," published in the Michigan Law Review, June, 1906.

advantage had been taken of him or other stockholders? Then the mere showing that the two corporations between which the contract is made have common directors should constrain the court to look into the matter. The courts have not yet given the individual stockholder or the small group of stockholders adequate powers of interference in such cases. And they have not yet allowed them that freedom in the examination of the books and papers of the corporation without which this right would often be empty and meaningless. It is in these two directions that improvement can be made—but improvement can be made in them without great difficulty, for the advance lies along a beaten track. There are no trails to blaze.

It follows as a natural conclusion that so far as the private interest—the interest of the stockholder—is concerned, legislation at this time prohibiting interlocking directorates—except in exceptional cases—or interlocking principals, would be premature. It is doubtful whether, from the private point of view alone, such legislation will ever be necessary, provided the courts take good care of the intercorporate contracts, extending their good offices in the further strengthening of the stockholder's position.

The dividing line between the public and private or stockholder's interest and point of view in this group of problems is sharp. The public question is economic, to some extent political and social; the stockholder's problem is almost entirely one of profit and loss. In a word, the public problem is the anti-trust problem, the problem of competition and combination. It is not intended to discuss the trust question. It may be said at once that what is said here rests upon a belief in the economic expediency and the social advantage of a general competitive regime in which limited competitive combination or cooperation, in other words a reasonable as distinguished from a monopolistic modus operandi, is allowed to play a significant but an incidental and therefore subordinate rôle. The kind of combination or cooperation that is not allowed to block the movement and free development of equal economic opportunity, is but the logical evolution and expression of one form of highly developed competitive efficiency. What bearing then have intercorporate directorates, intercorporate ownership, and contracts between corporations having common directors or owners, upon the question of competition and combination?

It is at once obvious that if two or more corporations have boards of directors so constituted that an acting majority or even a highly influential minority of those on one board are members of the

other board or boards these two or more corporations may with great facility be made to work together—almost as though they were one. This assumes of course that they are corporations which in their nature can work together. The presence on a local New England real estate corporation's board of a majority of the directors who constitute the board, let us say, of a corporation engaged in lighterage in New York harbor would be utterly without significance. These two corporations would never play into each other's hands, nor could they well take advantage of each other. But where the corporations are of such a kind that between them there could be combination, horizontal or vertical, the presence of common directors becomes of the utmost significance. A railroad needs freight, the freight producer needs the railroad—with interlocking directorates they are often as good as combined. A steel producing company needs ore, an ore producing company wants a good market for its product—give them common directors and often they are more than united, they are almost coalesced. The United States Steel Corporation, the International Harvester Company, the American Sugar Refining Company are all illustrations of vertical combination; and as for illustrations of horizontal combination, they are also found in these companies as they are in a legion of others.

In some cases such combination by the interlocking of directorates will offend public policy. In other cases it may be said to be directly in line with it—as when non-competing railroads are thus combined. The public policy of nearly all our states in the past has favored the consolidation of non-competing railroads, and common directorates is a promising step toward such consolidation.

But if combinations in unreasonable restraint of trade are to be condemned, then wherever two or more corporations are engaged in practices that are destructive of competition, and it can be shown further that they have interlocking directorates, the presumption becomes exceedingly strong that they have in effect combined to restrain trade. The interlocking directorate in such cases is the visible symbol of an inward and secret transgression of the law. Should not the fact of common directorates be laid hold of by the law in such circumstances and be used to fasten the presumption of illegal practices upon the corporations concerned? Some would go further, prohibiting absolutely all interlocking directorates in the case of competing corporations. But the rebuttable presumption may prove adequate.

When, in addition to the common directorates, there are contracts in common, or contracts between the interlocked corporations, the

government's case may usually be considered made. Between such corporations there must usually be such contracts, written or word-of-mouth, or if not contracts then "gentlemen's" or other equally intelligible agreements—so that once the fact of interlocking directorates is established a *subpoena duces tecum* or a rigid cross examination of the gentlemen agreeing is likely to mean death in the pot.

However, this is not all of the matter. We may pin down the intercorporate contract, we may ventilate the interlocking director, and find ourselves still outside the gates. By example we should tread softly here. We now approach a subject around which some law officers and many other persons have been tiptoeing, much as though they were attendants in a sick room or a sanctuary.

There are of course corporations normally competitive which have interlocking directorates without interlocking ownership. On the other hand there is interlocking ownership without interlocking directorates. A and B. may own a majority of the stock in corporation No. 1 and a majority of the stock in corporation No. 2, and an influential part of the board of directors of the first corporation may or may not constitute a part of the board of directors of the second corporation. It does not make very much difference. In any case, the problem is about the same. When the corporations have a sufficient number of common directors they will tend to be managed in a common interest. When they lack the common directors but have common owners every director will tend to be either dummy or Good Man Friday. He will know his master's voice and when to heed it.

Interlocking ownership so far has seemed to bear a charmed life. Now there may good reasons for this. There must be some reason for it. There must be some reason why bills are framed against the agents, the common directors—while the common owners, the principals, are entirely passed by. Perhaps it is because of that commendable spirit of thorough experimentation which bids the wise to make haste slowly; to go ahead, but first to have some idea of the directions. Perhaps it is due to a conviction, conscious or subconscious, that common ownership is not necessarily an evil thing, that the evil lies only in practices that are in unreasonable restraint of trade, and that it is possible to have common ownership and legal practice. In some cases no doubt this is true. But in others it seems to require a faith in human nature little short of the sublime, and therefore of course sometimes not far removed from the ridiculous. Unless, which seems entirely possible, a combination reconstituted as a combina-

tion of common owners may be said to have suffered a sea-change "into something rich and strange" and in its new condition be given a charter of indulgences permitting it to do what before was in violation of the law. Or it may be that interlocking ownership has enjoyed this immunity from attack because of much doubt as to just how far the government can go, constitutionally and practically, in compelling the owners of illegally combining properties to liquidate their properties in part to others. The practical difficulty of a thorough-going measure of this kind would assuredly be extreme, while its constitutional implications might prove most embarassing.

As a matter of fact all of these things and more must be taken into consideration in any attempt to do justice to the existing state of mind—to its blind side as well as to the side on which an optic nerve is beginning to develop. It was only yesterday, so to speak, that the significance of common ownership was thrown into sharp relief, when the Standard Oil agglomeration emerged from its ordeal of disintegration seemingly more closely integrated, more thoroughly concentrated, more narrowly held than ever before, so far at least as common ownership is concerned. The Standard Oil system stands dissolved and the little shareholders in it own perhaps less than they did before, the big shareholders more. Genius itself could not have contrived a scheme betted adapted to the automatic and perfectly noiseless elimination of the little fellows.

It is perhaps not to be wondered at that the political physician still remains transfixed, that the lips of the prophets are dumb—though of course there is no big surprise without its sequel. It may be that we have some preliminaries of the sequel already, in the Union Pacific-Southern Pacific decree. How far-reaching the principles enunciated in that decision may prove to be remains to be seen.

Moreover the anti-trust evolution is just now at a point—and, must it not be said, a healthy one?—where most attention is directed to practices, to acts, to deeds; to the nature and the incidence of those things which tend to throttle healthful competition, and make desert the conditions under which opportunity for men of little means and power flourishes. We have reached the point where we may hope to see Congress and the government come to grips with realities. Something already has been done. We are on the threshold of this achievement. One or two pushes—how great the misfortune of the pulls backward!—and the government will be straight over the bars, laying about it right and left, at the cut-throat price discriminations, at the stifling of competitors by refusing to sell anything to those who will not buy everything, at monopoly espionage, at fake independence, at any and every similar de-

vice. We shall have regulation of competition, regulation of reasonable cooperation, of combination that is not destructive of opportunity, more liberty, and more enterprise.

It is not surprising that with a prospect of being thus engrossed we should not yet have begun to examine very critically the more or less abstract questions of interlocking directorates, or the perhaps even more abstract questions of interlocking ownership.

There is in this an excellent chance of escape for director or owner who in the past has directed or owned to the end that trade might be unreasonably restrained. If he is intelligent enough to take warning from the growing demands for the suppression of practices inimical to a régime of economic freedom and justice—and as director or owner of one corporation can achieve the feat of truly competing with himself as director or owner of the other—he may be allowed to lead his dual and difficult life in all the peace that is economically possible. But if he does not do this—if he lacks the requisite intelligence to do it—he may well beware the bale that is in store for him. For suppose that in the effort to put an end to practices that stifle competition and throttle opportunity, the struggle should seem vain — and largely perhaps because of interlocking contracts, the interlocking directorate or the common owners. Suppose that the men earnestly working for the improved conditions become convinced of that. Does any one doubt what they will do? Will they hesitate to suppress such contracts? The courts have already shown the way to do that and in many instances they have done it. Will they stop at the interlocking directorates? The legislatures, state and national, have already entertained some measures of this kind, and at least one of them enacted into law has been most successful. Will they stop even at common ownership? Perhaps there they may pause and look about them questioningly, but that they will stop there if the common welfare urges them onward, who will prophesy?

We know that there is a very general feeling among laymen and a certain conviction among lawyers that under our system of jurisprudence there is no way of preventing a man from owning almost anything he pleases and as much of it as he pleases, provided he has the means of acquiring it. But once the demand arises and becomes distinct, a demand of the deliberate majority, we may be surprised at the comparative ease with which the change is brought about—and brought about according to the forms of existing law. Today many might ridicule any suggestion that through the power of taxation, the power of eminent domain, the "police power," the power to grant and so to limit corporate franchises, or the power to control

interstate or intrastate commerce, really practical and effective limitations could be put upon the amount of stocks of a given kind that any man could own. But each of these branches of the law—taxation perhaps the least, the power to restrict corporate franchises and the power to control commerce perhaps the most—contains the seed from which in the fertile soil of judicial construction or extension some hardy plants may grow.

Perhaps the least difficult device for control of interlocking ownership—but one not without many difficulties under our dual government—would be to grant corporate franchises only to those who own no stock or only a limited amount of stock in competing corporations, making this restriction a condition on breach of which the corporation's franchise would be forfeited. No one who realizes the tremendous extent of power which Congress has over interstate commerce—how it reaches into details, into incidents but remotely related—no one who has observed the almost furious pace at which this power has developed and is still developing, could be very greatly surprised if out of it there should be evolved far-reaching limitations upon the amount and character of stockholdings in all corporations engaged in interstate commerce, corporations which now include the big manufacturing or industrial corporations with the others.[3]

The time may not yet have come for broad, general laws forbidding intercorporate directorates. For the next few years we seem destined to give most attention to deeds, to the acts that are hostile to our economic and social welfare. It is well that the emphasis is placed there. The energy that seems now behind it might be dissipated, even destroyed, if it were sunk in the abstractions of mere organization. But we shall be fatuous beyond belief if in hammering at deeds we lose sight of these abstractions, for they embrace the real. There are even now certain corporation aggregations which menace the movement against destructive trade practices and agreements, chiefly because of the fact that they are dominated by common directors or common owners. If in any cases the situation is worse than this, if there is beyond a preponderance of doubt a class of corporations in which interlocking management means an inevitable breach of that public policy which has declared for reasonable competition and fair opportunity, there can hardly be a choice.

[3] It may be that the existing Anti-Trust legislation, with some not fundamental changes, will prove adequate to accomplish such an end, should there prove to be a public need for it. Since this paper was written Attorney General Wickersham's proposition for the regulation of the Union Pacific and Southern Pacific stockholdings—a direct blow to interlocking ownership—has been made.

Interlocking management for that specific class of corporations will have to give way or the public policy itself will have to give way.

Large-scale production may be desirable, in some branches of trade it is undoubtedly essential to prosperity. We should do everything possible to mediate between those economic forces which make toward the most efficient units of production and the struggle of individuals for freedom of opportunity, which is even more important. Mediation of course is far removed from dogmatic politics. It puts the emphasis on the facts; condemns the contract between interlocking corporations only when it is contrary to the interests of the private stockholder or offends public policy; condemns interlocking directorates where the facts show that they should be condemned, and therefore in the absence of sufficient information waits a while before it makes up its mind; condemns the common ownership of competing corporations only when it is demonstrated that neither the surveillance of such corporations, the supervision of their contracts, nor the prescription of their organization has been enough. Mediation, however, is not mere meditation. Its time is now and its method is one of ceaseless activity.

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